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UNCLAS SECTION 01 OF 03 SANTO DOMINGO 007456

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SUBJECT: ASSISTANT SECRETARY NORIEGA GETS IMF READOUT ON DOMINICAN NEGOTIATIONS

REF: SANTO DOMINGO 7134

1. (SBU) Summary: In a December 11 meeting, International Monetary Fund representatives told WHA Assistant Secretary Noriega that they were close to agreement on a new IMF program for the Dominican Republic, but expressed concern that recent steps by Mejia to "talk down" the exchange rate could stall negotiations. Though agreement was close on fiscal reforms, managing the ballooning quasi-fiscal deficit and tightening monetary policy deficit will be difficult. The Fund representatives said a deal would be fragile. At a separate meeting, private sector representatives pointed to the confrontational atmosphere between business and government. They criticized the GODR for excessive spending, corruption, and weak banking supervision. They decried reports of new tax proposals under the prospective IMF agreement. End Summary.

2. (SBU) Assistant Secretary for Western Hemisphere Affairs (WHA) Roger Noriega met with IMF Senior Advisor Rangid Teja, Division/Mission Chief Marcelo Figuerola, Deputy Division Chief Steven Phillips and Temporary resident Representative Ousmene Mandeng December 11 to hear the Fund's views on current negotiations of a new Standby Agreement and to urge support for quick disbursement of International Financial Institution (IFI) loans once a program is in place. Ambassador Hertell, DCM, Treasury desk Officer and emboffs participated in the meeting. A/S Noriega heard private sector views at a luncheon with prominent local business leaders representing banking, industry, energy, tourism and free zone sectors.

QUALITY OF FISCAL ADJUSTMENT LOW

3. (SBU) IMF Senior Advisor Teja reported substantial progress in the negotiations, noting that they were close to agreement on a fiscal package, but cautioned that the quality of the fiscal adjustment was "low." Teja said that the revenue measures in particular were weak and probably not sustainable. However, he added, under the current economic and political circumstances, the measures were probably as good as the GODR could achieve, and they would serve as a "stop-gap," pending more comprehensive fiscal reform. He said that the GODR needed to remove exemptions currently in effect (for items such as medicines and school supplies). Teja said that 80 percent of the fiscal adjustment would come from spending cuts.

ELECTRICITY A CONCERN

4. (SBU) Fund representatives noted that the one of the "good measures" in the prospective agreement was partial elimination of electricity subsidies. Currently, the GODR provides a subsidy to all consumers for the first 300 kw of electricity consumed each month. Under a new proposal, the GODR would subsidize only customers who use less than 200 kw/month. The GODR would also impose tariff increases on all users who exceed the 200 mw ceiling. Teja projected that reduction in subsidies, when implemented, would allow the distributors to meet fuel-purchase needs in the short term, but would not be sufficient to amortize accumulated arrears. Responding to a question about reports from generators that fuel supplies would be depleted by late December, Teja said that the Fund had been in contact with the World Bank concerning a short-term strategy to "keep the lights on." However Teja commented that the IMF team were on shaky ground with regard to immediate World Bank assistance. It might be that the GODR needed to look for other possibilities.

YES, NEW TAXES

5. (SBU) The officials from the Fund confirmed that the GODR would propose a series of additional tax measures, including a five-percent export tax, a two-percent import tax and an excise tax on alcohol and tobacco. These taxes are in addition to a doubling of an "exchange rate" tax (based on import values stated on invoices), from 4.75 percent to 10 percent; an increase in airport departure fees (from USD 10 to USD 20); and a .15 percent check cashing fee. The government had previously tried to implement the export tax by presidential decree, but the Supreme Court ruled that taxes could be levied only by congress. Nevertheless, the GODR has continued to collect the two-percent export tax, as

well as the check-cashing and airport fees that were implemented by the Monetary Board.

THE QUASI-FISCAL DEFICIT

16. (SBU) The IMF has identified the ballooning amount of Central Bank short-term debt certificates and the corresponding increase in the quasi-fiscal deficit as a crucial issues for the GODR. Teja said that the GODR started paying out cash in November to meet interest payments on certificates and stressed the need for the GODR to slow monetary growth. The Fund did not offer details of how the GODR might manage the Central Bank certificates, but commented that Paris Club rescheduling could provide some relief.

EXCHANGE RATE POLICY

17. (SBU) Teja said that the President's recent appointment of a commission to undertake vigorous enforcement in the exchange market (reftel), had become a very important issue that could delay the agreement. He said that a specialist from the Fund had just arrived in the country to study the matter. Teja explained that taken individually, none of the statements or actions taken by the GODR with regard to the exchange rate would be cause for concern -- "however, the totality of the picture is intimidation." He noted a sharp reduction in trading and suggested that the recent arrests of illegal exchange traders were intended to preclude emergence of a black market.

PRIVATE SECTOR CONCERNS

18. (SBU) In a lunch with the Assistant Secretary earlier the same day prominent representatives of the private sector agreed that there was a crisis of confidence in the government and expressed doubt about the efficacy of an IMF program. They pointed to the upcoming elections and the dramatic growth in the budget under the Mejia administration. One interlocutor remarked that the GODR would agree to an IMF program now, but by February it would exceed fiscal targets due to spending on reelection of Mejia. He said that the USG should tell Mejia to set aside ambitions for re-election for the good of the country.

19. (SBU) Several of the businesspeople attending the lunch spoke out forcefully against the various tax proposals under consideration. They said the five-percent export tax, in particular, would have a devastating effect on the manufacturing sector, but suggested that the GODR was incapable of enforcing other forms of taxation. Elena Viyella, the vocal president of the Association of Entrepreneurs (CONEP), said that exporters would support a tax of 2.5 percent.

10. (SBU) The group was also critical of the government's handling of the banking crisis that led to the present economic crisis. They said the GODR violated its own banking laws by bailing out a small number of large investors, and said that banking supervision was very weak, with no clear authority. One member participant expressed serious reservations about the Systemic Risk Law the GODR has submitted to Congress. Although passage of the law is a precondition of an IMF agreement, she noted that it gave too much power to the Executive Branch and did not provide penalties for illegal banking acts. Some members of the group expressed skepticism about the President's comments directed at lowering the peso/dollar exchange rate. They said that similar efforts had failed twice before in this country, in the 1980s. They seemed to agree that there was a real danger the peso could fall further and that the GODR might use "boots and guns" next time.

COMMENT

11. (SBU) The GODR is facing complex economic challenges and has few options other than a Fund agreement. The GODR is likely to continue to press to meet conditions for quick disbursement of IFI loans. Passage of the budget appears likely, despite substantial private sector opposition to the proposed tax measures. Though the private sector acknowledges the need for the IMF, it has a visceral distrust of this government.

HERTELL